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No. 127

Supreme Court of the United States

OCTOBER TERM, 1934

EVELYN F. GREGORY,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

HUGH SATTERLEE,
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GEORGE W. SAAM,
ROLLIN BROWNE,
CHARLES A. ROBERTS,
Of Counsel.

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No. _____

EVELYN F. GREGORY,

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v.

GUY T. HELVERING, Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

May it please the Court:

Evelyn F. Gregory applies for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit (R. 56), which reversed an order of the United States Board of Tax Appeals redetermining a deficiency in income tax for 1928 (R. 20), and respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF MATTER INVOLVED

In 1928 the petitioner owned all the stock of the United Mortgage Corporation, which held among its assets stock

of the Monitor Corporation. To facilitate a sale of the stock of the Monitor Corporation with the least burden of taxation the following plan was conceived and consummated:

A new corporation, the Averill Corporation, was organized. In exchange for the transfer to it by the United Corporation of stock in the Monitor Corporation, the Averill Corporation issued all of its stock, which was distributed to Mrs. Gregory, the sole stockholder of the United Corporation, without the surrender by her of her stock in the United Corporation. A few days later the Averill Corporation was dissolved and distributed the stock of the Monitor Corporation as a liquidating dividend to Mrs. Gregory, who thereupon sold such stock.

Giving effect to these transactions the petitioner maintained that the distribution to her of the Monitor stock by the Averill Corporation was a distribution in complete liquidation of the Averill Corporation, which was subject to tax in the amount and at the rate provided in the Revenue Act of 1928 with respect to liquidating distributions. The Commissioner of Internal Revenue determined that the petitioner received the Monitor stock as an ordinary dividend subject to tax in the amount and at the rate provided with respect to ordinary dividends. The Board of Tax Appeals sustained the petitioner's position. The Circuit Court of Appeals, disagreeing with both the Board and the Commissioner, held that the petitioner received the stock of the Averill Corporation (not of the Monitor Corporation) as an ordinary dividend from the United Corporation taxable at surtax rates, the resulting tax being the same in amount as that determined by the Commissioner. In so holding the Circuit Court of Appeals overruled the petitioner's contention, which had been upheld

by the Board of Tax Appeals, that the transfer of the Monitor stock to the Averill Corporation in exchange for the issuance of the stock of the Averill Corporation constituted a "reorganization" as defined in the statute.

The Revenue Act of 1928, with precise particularity and in identical language with the Revenue Acts of 1924, 1926, 1932 and 1934, in Section 112 (i) (1) (B) defines "reorganization" as a transfer by a corporation of a part of its assets to another corporation if immediately thereafter the transferor corporation or its stockholders or both are in control (that is, hold at least 80 per cent. of the stock) of the transferee corporation. In Section 112 (g) the Act permits the distribution free from tax of stock of a corporation "a party to a reorganization" as defined by the statute. It is clear that the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to the petitioner were not subject to tax if the language of the statute be accorded its ordinary meaning. In reaching the contrary conclusion the Circuit Court of Appeals reasoned that, although a purpose to avoid taxation does not vitiate a transaction, and the Averill Corporation had a juristic personality which could not be ignored, nevertheless "it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition."

The question presented, therefore, is:

Is a given transaction to be considered as falling within or without the statutory definition of reorganization, dependent on whether or not it was undertaken for the purpose of avoiding or reducing tax liability?

More specifically, is a transfer by a corporation of a part of its assets to another corporation, where immediately

after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, not a "reorganization" within the meaning of Section 112 (i) (1) (B) of the Revenue Act of 1928, if the purpose of the transaction is reduction of taxes?

B.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. It is not an exaggeration to say that the decision of the Circuit Court in this case is revolutionary. Ever since the first enactment in the Revenue Act of 1924, and the continuance in subsequent acts with minor changes, of elaborate, precise and comprehensive provisions governing the taxability of exchanges and reorganizations, taxpayers and their counsel, and until recently the Treasury Department, have acted and advised in reliance upon the plain propositions of the statute, regarding as non-taxable, transactions within the scope of the language given its ordinary significance, and regarding as taxable, transactions outside such scope, irrespective of motives and purposes whether of tax avoidance or otherwise. It made no difference, because the statute furnished its own definition, that many transactions within the statute were not reorganizations to a banker or to the man in the street or in the ordinary legal sense, which usually connotes the compulsion of financial difficulties.

But now, under the decision of the Circuit Court, the purpose of the transaction would become more important than what was actually done, and for the provisions of

the statute would be substituted the guess of each court in each case as to whether the ultimate object of the taxpayers was within the unexpressed intent of Congress. It is impossible for counsel to advise clients as to the effect of prospective transactions on their tax liability, or for clients safely to undertake readjustments of their affairs, when a strict compliance with the statutory provisions as they are written would be as likely to prove a trap as a refuge. No two courts could be counted on to agree on what were permissible purposes, once having abandoned the safe and sure ground of the statutory definition.

This is a question of enormous practical importance. Counsel have received numerous communications from lawyers in various parts of the country, all expressing amazement at the decision of the Circuit Court and urging application for a writ of certiorari. This wide concern is not strange when it is recalled that thousands of reorganizations, just now coming before the courts for consideration, were consummated in the late 1920's in reliance on what was regarded as the unambiguous language of the statute and on the administrative acquiescence in such interpretation. In the reversal of the position of the Treasury Department so late in the day, and in the pronouncement of a novel decision such as that of the Circuit Court of Appeals in this case, taxpayers feel bewildered and unable with any certainty to estimate their tax liability whether in respect of reorganizations which they had undertaken with full assurance of their conformity with the statute or in respect of prospective reorganizations now in contemplation.

2. The Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable de-

cisions of this Court. It has often been held that the words of a statute should be taken in their plain popular meaning, and that unambiguous language permits no resort to extraneous considerations. *Woolford Realty Co.* v. *Rose,* 286 U. S. 319; *United States* v. *Kirby Lumber Co.,* 284 U. S. 1, 3; *Crooks* v. *Harrelson,* 282 U. S. 55. Where a statute has had a consistent practical construction, and Congress has repeatedly re-enacted the same language, the conclusion is required that such construction was not inconsistent with the intent of the statute. *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U. S. 269; *Old Colony R. R. Co.* v. *Commissioner,* 284 U. S. 552; *Poe* v. *Sanborn,* 282 U. S. 101; *Wisconsin* v. *Illinois,* 278 U. S. 367, 413. A purpose to avoid taxes is immaterial. *Superior Oil Co.* v. *United States,* 280 U. S. 390; *Bullen* v. *Wisconsin,* 240 U. S. 625; *United States* v. *Phellis,* 257 U. S. 156.

The precise point of the construction of Section 112 (i) (1) (B) of the Revenue Act of 1928, embodying a definition of "reorganization", has not heretofore been presented to this Court, but it has had occasion in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, to consider the disjunctive definition of "reorganization" in Section 112 (i) (1) (A) of the 1928 Act. In that case the Court disapproved the construction of the Circuit Court of Appeals for the Fifth Circuit as not giving effect to all of the words in the definition, and as conflicting with the established practice of the tax officers and likely to produce perplexity.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and de-

termination on a day certain to be therein named a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 13,158, *Guy T. Helvering, Commissioner of Internal Revenue, Appellant* v. *Evelyn F. Gregory, Appellee*", and that said judgment of the Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

June 25, 1934.

EVELYN F. GREGORY,
by HUGH SATTERLEE,
Counsel for the Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF COURTS BELOW

The opinion in the United States Board of Tax Appeals is reported in *Evelyn F. Gregory* v. *Commissioner of Internal Revenue,* 27 B. T. A. 223 (R. 14); and the opinion of the Circuit Court of Appeals for the Second Circuit, rendered March 19, 1934, is reported in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Evelyn F. Gregory,* 69 Fed. (2d) 809 (R. 52).

II.

JURISDICTION

This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stats. 938. See *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716. The date of the judgment sought to be reviewed is March 26, 1934 (R. 56).

III.

STATEMENT OF CASE

By 1928 the petitioner, Mrs. Gregory, had acquired all the stock of United Mortgage Corporation (R. 22, 30).

On September 18, 1928, Averill Corporation was organized, and on September 21, 1928, pursuant to a plan of reorganization or readjustment, United Mortgage Corporation transferred a part of its assets, consisting of stock in the Monitor Securities Corporation, to Averill Corpora-

tion in exchange for the issue by Averill Corporation of all of its stock, which was distributed to Mrs. Gregory, the holder of all the stock of United Mortgage Corporation, without the surrender by her of her stock in United Mortgage Corporation (R. 22, 31, 32).

On or about September 24, 1928, Averill Corporation was dissolved and distributed in liquidation to Mrs. Gregory, the holder of all of its stock, all of its assets, consisting of stock in the Monitor Corporation. Immediately thereafter Mrs. Gregory sold the stock of the Monitor Corporation (R. 22, 23, 32).

Mrs. Gregory reported a capital gain on the distribution in liquidation to her of the stock in the Monitor Corporation. The Commissioner of Internal Revenue determined, in lieu thereof, that she received an ordinary dividend upon the distribution to her of the Monitor stock. The Board of Tax Appeals held that Mrs. Gregory realized a capital gain upon the distribution in liquidation of the Monitor stock, and not an ordinary dividend (R. 23). The Circuit Court of Appeals held that Mrs. Gregory received a taxable dividend upon the distribution to her of the stock of Averill Corporation, and neither a capital gain nor a taxable dividend upon the distribution to her of the Monitor stock (R. 52).

IV.

SPECIFICATION OF ERRORS

1. The Circuit Court of Appeals erred in holding that the distribution to Mrs. Gregory of the stock of Averill Corporation, without the surrender by her of her stock of the United Mortgage Corporation, constituted a taxable dividend.

2. The Circuit Court of Appeals erred in holding that the transfer by United Mortgage Corporation of a part of its assets to Averill Corporation, in exchange for the issue of all the stock of Averill Corporation, was not a reorganization within the definition of reorganization in Section 112 (i) (1) (B) of the Revenue Act of 1928.

3. The Circuit Court of Appeals erred in refusing to give effect to the plain language of the statute and its specific definition of reorganization because of the assumption that Congress did not mean to cover a business transaction undertaken to reduce taxes on the disposition of an investment.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals, which was supported by the findings of fact.

V.

ARGUMENT

A. No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation without the surrender by her of the stock of United Mortgage Corporation; for

B. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the definition of the statute; and

C. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was no less a reorganization because the purpose was to minimize taxes.

A.

No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation without the surrender by her of the stock of United Mortgage Corporation.

The distribution of the stock of Averill Corporation to Mrs. Gregory was in pursuance of a plan by which part of the assets of the United Mortgage Corporation, consisting of stock of the Monitor Corporation, was segregated in a separate corporation, to wit, Averill Corporation, controlled by Mrs. Gregory. Section 112 (g) of the Revenue Act of 1928 provides:

> "(g) **Distribution of stock on reorganization.**—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

If, then, the transfer of part of the assets of United Mortgage Corporation to the Averill Corporation was a reorganization within the definition of the statute, there was distributed in pursuance of the plan of reorganization to Mrs. Gregory, the sole stockholder of United Mortgage Corporation, a party to the reorganization, stock of Averill Corporation, also a party to the reorganization, without the surrender by Mrs. Gregory of her stock in the United Mortgage Corporation; and therefore no gain to Mrs. Gregory from the receipt of such stock of Averill Corporation was recognizable.

There is no dispute about the validity of this conclu-

tion, assuming the existence of a reorganization. The only issue raised by the opinion of the Circuit Court of Appeals is whether or not there was a reorganization within the definition of the statute.

B.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the definition of the statute.

Section 112 (i) (1) (B) of the Revenue Act of 1928 provides:

> "(i) **Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term 'reorganization' means * * * (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred", * * *.

Here there was a transfer by United Mortgage Corporation of a part of its assets, consisting of stock of the Monitor Corporation, to another corporation, namely, Averill Corporation, and immediately after the transfer the transferor, that is, United Mortgage Corporation, or its stockholders, comprising Mrs. Gregory, or both, were in control of the corporation, that is, Averill Corporation, to which the assets were transferred. "Control" under Section 112 (j) means the ownership of at least 80 per cent. of the stock of a corporation.

The precise transaction contemplated by the statute,

the segregation of part of the assets of a corporation in another corporation, with immediate control of the second corporation in the first corporation or its stockholders, was undertaken and accomplished here. No more complete conformity with the statutory definition could possibly be imagined. No element or factor was lacking: what was accomplished was exactly what the statute said and meant, unless the plainest possible language may be ignored.

C.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was no less a reorganization because the purpose was to minimize taxes.

The Circuit Court expressed itself as in agreement with the Board of Tax Appeals and the taxpayer that a transaction does not lose its immunity from tax because it is actuated by a desire to avoid taxation, and that anyone may so arrange his affairs that his taxes shall be as low as possible. The Circuit Court also agreed, in disagreement with the Commissioner, that it could not treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by Averill Corporation of its own shares to Mrs. Gregory, and her acquisition of the Monitor shares by winding up Averill Corporation, and that all these steps were real. In short it affirmed, as has so often been recognized by the courts, that a purpose to minimize taxes is immaterial and constitutes no warrant for ignoring corporate entity.

Having rendered lip service to these fundamental principles, however, the Circuit Court jumped to the conclusion

that Congress did not mean to cover by its definition of reorganization a transaction which was entered into for the purpose of minimizing taxes. To counsel it seems that the Court stultified its previous declaration of principles and in effect decided that the purpose of a transaction, and not what was actually done, determines its taxability.

At any rate, the result is to make meaningless the language of the statute and to relegate to the courts to decide in every case what is the controlling motive of a transaction and just where is the line of demarcation between two transactions which equally conform with the language of the statute, but which may be carried out with differing objects in view. It is an impossible situation from the standpoint of tax administration, and from the standpoint of taxpayers, who are entitled to know in advance whether or not a transaction is likely to involve them in burdensome taxation.

Suppose Mrs. Gregory, instead of dissolving Averill Corporation almost immediately after receipt of its stock, had kept it in existence for a year or so as a holding corporation separate from United Mortgage Corporation. The Commissioner, who did not determine any profit upon the distribution to her of the Averill stock, would obviously never have questioned the transaction, nor would anyone else have had the slightest doubt that it was a statutory reorganization. Suppose, instead of dissolving Averill Corporation, Mrs. Gregory had almost immediately sold its stock to strangers, which would have resulted in the same taxable profit actually reported by her. It is extremely unlikely that the consummation of the transaction in that form would ever have been questioned, because, as already noted, the Commissioner did not assert any gain on the distribution to Mrs. Gregory of the Averill stock. Yet in

these illustrative and typical variations it may be assumed that the purpose of the transaction was to minimize taxes. Where is the line to be drawn?

The Circuit Court indicates reliance on the history of the reorganization provisions. In the 1913, 1916 and 1917 Acts there were none. In the 1918 Act, in Section 202 (b), there first occurred a meager and general provision. In the 1921 Act, in Section 202, the reorganization provisions were somewhat amplified, but still were not explicit. In the 1924 Act, as a result of a conscious choice between the policy of a broad, general provision as to reorganizations, with the Treasury Department formulating regulations to cover the various species of reorganizations, and the policy of comprehensively covering the entire field by meticulously specific provisions, the latter course was adopted, and the elaborate provisions first enacted in Section 203 of the 1924 Act have been retained with minor changes in the 1926, 1928, 1932 and 1934 Acts. These reorganization provisions so far as material to the issue in this case are set forth in an appendix hereto.

The definition of reorganization with which we are concerned has remained unchanged for ten years in the successive statutes, including the 1934 Act, and thousands of reorganizations have been carried out under its terms with never a question having been raised, until the consideration of this case in the Circuit Court of Appeals, that a reorganization was not a reorganization if undertaken with the purpose of minimizing taxes. The applicable regulations of the Treasury Department, which are set forth in the appendix hereto, take no diverse view. After this decade of statutory reenactment without change, and of the practical construction of the statute both by the Treasury Department and by taxpayers, it is late in the

day to deprive a taxpayer of the benefit of the statute on the ground that Congress did not mean what it said.

The reorganization provisions are based on the realization that a corporate readjustment, when the ultimate interest of the stockholders in the assets remains substantially the same, does not as a practical matter and in essence give rise to gain or loss. If, then, the splitting up of the assets of one corporation between two corporations, where the stockholders of the first corporation also become the stockholders of the second corporation (so that the stockholders have the same ultimate interest in the same assets through holding stock in two corporations instead of one), does not result in recognizable gain or loss, the purpose of the readjustment is irrelevant. (See Appendix F.)

The Circuit Court quotes a Congressional report to the effect that the reorganization provisions were intended to exempt "from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented." The Court failed to observe that the "ordinary business transaction" here in question was the disposition of the Monitor stock. The earlier revenue acts had impeded capital transactions by subjecting the gain therefrom to progressively high rates like ordinary income. As a remedial measure, to encourage the free flow of capital, Congress finally provided for postponed taxation and lower rates wherever the taxpayer could bring his transactions within the prescribed categories of reorganizations and exchanges. We submit that the Court was mistaken in thinking that Congress did not intend to cover such a situation or that there is any inherent injustice in permitting the taxpayer to split her investment in corporate stock, apply an allocated

part of its cost in computing gain from the sale of a segregated portion of the investment, and receive the benefit of the special rate of taxation provided for capital gains.

The Circuit Court attempts to support its decision by reference to the decision of this Court in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, and to its own decision in *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937, saying that in those cases "the violence done the literal interpretation of the words is no less than what we do here". The situations are scarcely comparable. The *Pinellas* and *Cortland* cases were concerned with the definition of reorganization in Section 112 (i) (1) (A), which provides that the term "reorganization" means "(A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)," as may be seen by reference to the complete text of the paragraph set out in the appendix hereto. In the *Pinellas* case the Circuit Court of Appeals for the Fifth Circuit had assumed that Congress intended to use the words "merger" and "consolidation" in their ordinary and accepted meanings, and that giving the matter the most liberal construction it was only when there was an acquisition of substantially all of the property of another corporation in connection with a merger or a consolidation that a reorganization took place. This Court thought the construction of the Circuit Court of Appeals too narrow, noting that it conflicted with the established practice of the tax officers and might produce perplexity, and insisted that all the words in the definition be given effect.

In both the *Pinellas* and *Cortland Specialty* cases there was a sale for promissory notes, with no retention of control, and accordingly nothing resembling a merger or consolidation. The definition in clause (B), with which we are concerned, does not embody the words "merger or consolidation", but on the contrary makes perfectly plain that, as opposed to the combination of corporations or their assets contemplated by clause (A), clause (B) contemplates the segregation of corporations or their assets. The *Pinellas* and *Cortland* decisions adopted a logical interpretation of clause (A), but their reasoning has no application to clause (B) except as the opinion in the *Pinellas* case emphasizes that the words of the statute may not be disregarded.

No other decision of any court, no decision of the Board of Tax Appeals, and no published ruling of the Treasury Department, has ever to the knowledge of counsel denied effectiveness as a reorganization to the transfer by one corporation of a part of its assets to another corporation in exchange for its stock, where immediately after the transaction the first corporation or its stockholders or both have been in control of the second corporation through the ownership of at least 80 per cent. of its stock, regardless of the motives actuating the participants in the transactions or the purposes which they sought to achieve. The decision of the Circuit Court of Appeals has disregarded all precedent and practice, and has created confusion with respect both to prospective reorganizations and to past reorganizations. So long as this decision stands utter uncertainty will have replaced reasonable certainty.

As regards a host of consummated transactions, in respect of many of which the statute of limitations has already barred the Government from attempting to assert

its view of the *ratio decidendi* of the present case, the taxpayers will be encouraged, in connection with future sales of property involved in such doubtful reorganizations, to claim stepped-up bases for ascertaining gain or loss, as against using the cost to their transferors to which they would be restricted in reorganizations in which no gain was recognized. In short, it would be difficult to conceive a decision involving tax law which would be more certain to breed litigation, ultimately beneficial neither to the Government nor to taxpayers.

Conclusion.

It is accordingly respectfully submitted that this case calls for the exercise by this Court of its supervisory powers in order that the manifest errors of the Circuit Court of Appeals may be corrected, and that to such end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals and finally reverse it.

June 25, 1934.

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APPENDIX

A.

Revenue Act of 1918, Section 202 (b)

"SEC. 202. . . . . .

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

B.

Revenue Act of 1921, Section 202 (c)

"SEC. 202. . . . . .

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such prop-

erty, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized— . . .

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization", as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);" . . .

C.

Revenue Act of 1924, Section 203 (b) (c) (g) (h) (i)

Revenue Act of 1926, Section 203 (b) (c) (g) (h) (i)

Revenue Act of 1928, Section 112 (b) (g) (h) (i) (j)

Revenue Act of 1932, Section 112 (b) (g) (h) (i) (j)

The matter in italics below appears only in the provisions of the 1924 and 1926 Acts, which are identical.

The matter in brackets appears only in the provisions of the 1928 and 1932 Acts, which are identical except for the addition in the 1932 Act of the matter in small capitals.

Except for the new matter in the 1932 Act, the actual text of the provisions is the same in all four Acts.

"[SEC. 112] *Sec. 203.* . . .

(b) **[Exchanges solely in kind.—]** . . .

[(3) STOCK FOR STOCK ON REORGANIZATION.—] (*2*) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

[(4) SAME—GAIN OF CORPORATION.—] (*3*) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. . . .

[(g) Distribution of stock on reorganization.—] *(c)* If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

[(h) Same—effect on future distributions.—] *(g)* The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, IF NO GAIN TO THE DISTRIBUTEE FROM THE RECEIPT OF SUCH STOCK OR SECURITIES WAS RECOGNIZED BY LAW, shall not be considered a distribution of earnings or profits within the meaning of [section 115 (b)] *subdivision (b) of section 201* for the pur-

pose of determining the taxability of subsequent distributions by the corporation.

[(i) Definition of reorganization.—] *(h)* As used in this section and sections [113 and 115] *201 and 204*—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

[(j) Definition of control.—] *(i)* As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

D.

Revenue Act of 1934, Section 112

Section 112 (a)-(f) of the 1934 Act is identical with Section 112 (a)-(f) of the 1928 and 1932 Acts. Section 112 (g) of the 1928 and 1932 Acts is omitted in the 1934

Act; Section 112 (h), limited to apply only to years prior to 1934, appears as Section 115 (h) of the 1934 Act; and Section 112 (j) and (k) becomes Section 112 (h) and (i) in the 1934 Act. Section 112 (i) of the 1928 and 1932 Acts is modified in the 1934 Act to read as follows:

"(g) DEFINITION OF REORGANIZATION.—As used in this section and section 113—

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

E.

Regulations 74

The following regulations, similar to the corresponding articles of the regulations under the 1924, 1926 and 1932 Acts (no regulations having yet been promulgated under the 1934 Act), were issued by the Treasury Department for the administration of such provisions of Section 112 of the Revenue Act of 1928 as are here material:

"ART. 574. **Exchanges in connection with corporate reorganizations.**—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. If two or more corporations reorganize, for example, by—

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or

(4) The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation—then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.) . . .

ART. 576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

ART. 577. **Definitions.**—The term "reorganization," as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent. of the voting stock, and

(2) At least 80 per cent. of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

ART. 578. **Source of distribution of stock or securities.**—The general rule, provided in section 115 (b), that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to a distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or of stock or securities in a corporation a party to the reorganization. Such a distribution will not be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, which are available for distribution and which under section 115 (b) must be distributed before earnings and profits accumulated before March 1, 1913, may be distributed exempt from tax.

Example: The X Corporation has a capital of $100,000, earnings and profits accumulated prior to March 1, 1913, of $25,000, and earnings and profits of $50,000 accumulated after February 28, 1913. It causes the organization of the Y Corporation, to which it transfers $50,000 of its assets in exchange for all of the stock of the Y Corporation. It then distributes the stock of the Y Corporation as a dividend to its shareholders. No gain to the shareholders from the receipt of this stock will be recognized under the provisions of section 112 (g) and article 576, nor will the distribution be considered a distribution of earnings or profits in determining the amount of earn-

ings and profits accumulated since February 28, 1913, on hand for subsequent distribution as a dividend.

The provisions of this article apply to the case in which the X Corporation distributes the stock of the Y Corporation as a dividend, the case in which the X Corporation distributes the stock of the Y Corporation in retirement of a portion of the stock of the X Corporation, and the case in which the Y Corporation issues its stock direct to the shareholders of the X Corporation."

F.

Statement in Report No. 398 of Committee on Finance of Senate on Revenue Bill of 1924

(The same statement appears in Report No. 179 of the Committee on Ways and Means of the House (page 17), and in the statement of January 5, 1924, issued by A. W. Gregg, Special Assistant to the Secretary of the Treasury, who was largely responsible for drafting the reorganization provisions in the Revenue Act of 1924.)

"SECTION 203 (h): (1) Subdivision (h) (1) contains a definition of reorganization which corresponds to the definition contained in section 202 (c) (2) of the existing law. The only change in the definition is to include within its terms the case of a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders, or both, are in control of the corporation to which the assets are transferred. This is a common type of reorganization, and clearly should be included within the reorganization provisions of the statute."